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Supreme Court of the United States

OCTOBER TERM, 1937—No. 636.

ELECTRIC BOND AND SHARE COMPANY,
AMERICAN GAS AND ELECTRIC COMPANY,
AMERICAN POWER & LIGHT COMPANY,
NATIONAL POWER & LIGHT COMPANY,
ELECTRIC POWER & LIGHT CORPORATION,
UNITED GAS CORPORATION,
POWER SECURITIES CORPORATION,
LEHIGH POWER SECURITIES CORPORATION,
UTAH POWER & LIGHT COMPANY,
NEBRASKA POWER COMPANY,
PACIFIC POWER & LIGHT COMPANY,
UNITED GAS PUBLIC SERVICE COMPANY,
HOUSTON GULF GAS COMPANY,
APPALACHIAN ELECTRIC POWER COMPANY,
ATLANTIC CITY ELECTRIC COMPANY,
EASTON CONSOLIDATED ELECTRIC COMPANY,
THE OHIO POWER COMPANY,
PENNSYLVANIA POWER & LIGHT COMPANY,
THE SCRANTON ELECTRIC COMPANY,
THE WASHINGTON WATER POWER COMPANY,
CENTRAL ARIZONA LIGHT AND POWER COMPANY,
INDIANA & MICHIGAN ELECTRIC COMPANY,
IDAHO POWER COMPANY,
THE MONTANA POWER COMPANY,
SPOKANE UNITED RAILWAYS,
SPOKANE CENTRAL HEATING COMPANY and
MONTANA POWER GAS COMPANY,
Defendants-Petitioners,

against

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Respondent,

and

HOMER S. CUMMINGS, individually and as Attorney General of the United States, JAMES A. FARLEY, individually and as Postmaster General of the United States, and JAMES M. LANDIS, ROBERT E. HEALY, GEORGE C. MATHEWS, JAMES D. ROSS and WILLIAM O. DOUGLAS, individually and as constituting the Securities and Exchange Commission,
Cross-Defendants-Respondents.

REPLY BRIEF FOR PETITIONERS.

THOMAS D. THACHER,
JOHN F. MACLANE,
Solicitors for Petitioners.

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Respondents.

REPLY BRIEF FOR PETITIONERS.

Introductory Statement.

The Government's brief (a) evades or misconceives the fundamental issue in this case; (b) misrepresents the position of the defendants in general and in detail; and (c) deflects attention from the real issues by arguing *in extenso* for propositions that are not challenged and against contentions that are not made.

The constitutional issue in this case is clouded throughout by vague and loose references to defendants as "interstate holding companies" or "interstate utility enterprises". "The Act", the Government contends, "is aimed only at the holding company which controls operating utilities in states other than its domicile and which utilizes the channels of interstate commerce to carry out important and

essential holding company purposes'' (plaintiff's brief, p. 20). Such a company is, it states, an ''interstate holding company'' (*id.*). The statement, when analyzed and compared with the provisions of the Act, means that every holding company incorporated in one state which controls a utility company operating in another state becomes an instrumentality of interstate commerce if it engages once in any of the transactions enumerated in section 4(a)—for example, if it owns securities of an intrastate subsidiary which uses the mails or facilities of interstate commerce to acquire utility assets, *or* if it uses the mails or facilities of such commerce itself to sell investment securities which it owns, *or* if it owns the stock of a subsidiary which uses the mails or facilities of such commerce to sell investment securities.

Questions of the validity of specific regulations cannot be settled by referring to the companies regulated as ''interstate'' or ''intrastate''. The validity of specific federal regulations depends upon whether the specific activities regulated constitute or directly affect interstate commerce. We have shown in our brief (pp. 66-94) that the regulatory provisions of this Act are not confined to the regulation of such interstate commerce as may be performed by defendant companies. This conclusion is not in any way altered or affected by characterizing the defendants as ''interstate utility enterprises'' because of specific interstate activities in which they or one or more of their subsidiaries may engage.

Instead of answering the argument made in our brief, the Government rests its position (brief, p. 21) upon the generalization that '''By its very nature', the kind of holding company which falls within the Act 'transcends state

lines and is national in its scope and importance—characteristics which bring it within the purpose and protection, and subject it to the control, of the commerce clause'. *Fisher's Blend Station, Inc.* v. *Tax Commission,* 297 U. S. 650, 655."

The quotation is wrenched from a statement in an opinion of this Court characterizing radio broadcasting.

Fundamental Issue.

The fundamental issue in the main case is whether section 4(a) can be enforced. The suit was brought to enjoin defendants from engaging in the activities prohibited to unregistered companies by 4(a). The decree grants such an injunction. The main suit involves nothing but the validity of 4(a). It is either intrinsically valid, requiring nothing in its support, or it is auxiliary to other provisions of the Act in which support must be found.

While the Government loosely speaks of section 4(a) as a regulation (plaintiff's brief, p. 91, note), yet it is not argued that it is in itself valid. Therefore, the Government suggests that 4(a) may be coupled with 5(b) and enforced in conjunction with that section (p. 92). Thus, the Government, in common with the defendants, finds it necessary to seek extrinsic support in the Act for 4(a).

We submit, for the reasons stated in our brief, that section 5(b) is insufficient and we must necessarily turn to other provisions of the Act in search of such support. It is in this manner, and in this manner only, so far as the main case is concerned, that the other sections of the Act are involved. The Government cannot preclude the chal-

lenge of the other sections unless 5(b) of itself is sufficient to support 4(a).

It is admitted by plaintiff that registration under section 5(a) to avoid the penalties of 4(a) invokes the controls of the Act, not merely the registration statement called for by 5(b) but all the controls (brief, p. 53). But it seems to be assumed that 5(b) has a peculiar sanctity and cannot be attacked as auxiliary (or "fragmentary") to invalid controls until after such controls are judicially declared invalid (plaintiff's brief, pp. 83-90). This suit is not to enforce 5(b) but 4(a). The Commission has no more authority to enforce 5(b) against unregistered companies than it has any other section, and the validity of 5(b) is no more "immediately in controversy" in this suit than is the validity of any other section. 5(b) is involved here merely as a support to 4(a) and the question is of its sufficiency for that purpose.

Plaintiff's brief (p. 45, note) criticizes the statement (defendants' brief, p. 8) that the Government urges that whether or not the control system be constitutional, we may be required to submit to the "entire Act" without determination of the validity of the control sections. We make the contention and repeat it as a precise statement of the practical effect of the Government's position—registration invokes all the controls of the Act. The Government so asserts. We contend, and it is not denied, that those controls become operative the moment we register; some of them by the terms of the Act itself, others by rules and regulations of the Commission which have already been promulgated as to most of the important provisions.

It is not contended by defendants as asserted (plaintiff's brief, pp. 49-52), that registration as a matter of law pre-

cludes defendants from hereafter attacking consequent control provisions of the Act; the decree purports to protect that right. We do assert that the structure of the Act is such as greatly to delay and complicate any such attack. Contrasting the positions of the parties: the Government says submit first and litigate afterwards and we insist that we are entitled to litigate before submission if the controls consequent upon submission are invalid. It may further be added that we nowhere contend, as insisted throughout plaintiff's brief (pp. 46, 60 and elsewhere), that all of the controls must be valid to support the enforcement of section 4(a). We do contend that sufficient thereof must be valid to accomplish the apparent and declared objective of the Act (defendants' brief, pp. 7, 8, 55).

Separability of Registration Provisions.

The argument on the separability of the registration provisions commencing on page 47 criticizes (in the footnote on page 48) defendants' quotation from Judge Manton's opinion (defendants' brief, p. 56) that the separability clause is a command to sustain a particular section although the "warp and woof" are torn away. We are impliedly charged with sharp practice for seizing upon an *obvious typographical error*. Instead of being such an error it is a necessary premise to Judge Manton's argument and is inherent in the plaintiff's theory of the case. It is expressly argued, as above referred to, that a section cannot be dismissed as merely "fragmentary", even though the substance of the Act be invalid, until after an independent adjudication of such invalidity.

Throughout its brief, as in the courts below, the plaintiff has endeavored to preclude the Court from examining

this Act. It is expressly stated (plaintiff's brief, p. 54) that the purpose and effect of the registration provisions are the same "whether registration is considered as a separate statute regulating utility holding companies, or as but one part of a comprehensive statute. * * *" The entire argument refuses, and would have the Court refuse, to look at the statute to see what function Congress intended the registration provisions to perform *considering the statute as a whole.*

The citation of the opinion of the Chief Justice in the *Carter Coal* case to the effect that provisions should not be held inseparable unless their nature demands that construction is a misapplication of language to the situation here presented. Here registration admittedly is not separate from the control provisions in so far as it invokes them (plaintiff's brief, p. 53), and the "inextricable tie" exists. The Chief Justice was not discussing the relationship between the penalty in the *Carter Coal* case and either the price-fixing or labor provisions but the independence of the price-fixing and labor provisions as between themselves.

The argument on legislative history (plaintiff's brief, pp. 60-67) is particularly misleading. There is not a single citation of evidence that publicity was even a minor objective of the Act.

The quotation from the hearings before the Senate Committee (pp. 62-63) *"Registration itself affords the opportunity for the collection of full information regarding the holding company, and its related companies"* cannot be lightly passed. A quotation of the context which surrounds this sentence is conclusive refutation of any theory that the registration statement was actually intended by Congress to operate as a regulation of activities prohibited by

section 4(a), and shows that compliance with the regulatory provisions is the specified *"condition of the use of the mails and the channels of interstate commerce"* for those activities.

The context is:

> "The ultimate cure of the evils described in this introductory section which the bill adopts is the abolition of the holding company conducting activities in interstate commerce and by means of the mails, except where it is necessary for the operation of a geographically and economically integrated public-utility system. This prohibition is postponed, however, to permit orderly liquidation and reorganization, and so to prevent unnecessary destruction of existing security values. The bill also prescribes regulation designed to furnish protection to investors and consumers during the remaining period of holding-company existence, and as a permanent measure in the case of those companies that are permitted to continue. This is achieved through registration. It is made unlawful for a holding company to make certain uses of the mails or the instrumentalities of interstate commerce unless that company is registered with the Securities and Exchange Commission; the regulatory provisions of the bill are then directed, not at holding companies generally, but at registered holding companies and their subsidiaries. *Thus compliance with these regulatory provisions is made a condition of the use of the mails and the channels of interstate commerce for the transportation or transmission of gas or electricity, the making or performance of service, sales, and construction contracts, the marketing of securities, the acquisition of securities and capital assets and the performance of any business in interstate commerce; it is also made a condition of the owner-*

> *ship of securities in certain other companies that conduct these specified interstate activities or otherwise engage in interstate commerce, and of the continued existence of a holding company*[1] which has during the past 10 years distributed securities in interstate commerce which are now outstanding in the hands of persons residing outside of the State in which the holding company is incorporated. The regulation imposed through this device of registration is directly related in all its details to the elimination of the evils described at the outset.
>
> *Registration itself affords the opportunity for the collection of full information regarding the holding company and its related companies.*[2] Further information must be filed before a security may be issued by a holding company, and security issues are made the subject of complete regulation, designed not merely to afford full disclosure of all relevant facts to prospective investors, but also positive protection against recurrence of the 'wild-cat' financing of the past."

See Hearings before the Committee on Interstate Commerce, United States Senate on S. 1725, p. 808.

It is suggested that defendants contend that simplification or elimination of holding companies is the single declared objective of the Act (plaintiff's brief, p. 63). We make no such contention anywhere. It was argued in the District Court, and is argued here, that this simplification or elimination was in fact the dominant objective of the

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[1] Emphasis supplied; *cf.* defendants' brief, pp. 59-60, 62-63.

[2] Emphasis supplied to indicate setting of quotation in plaintiff's brief. See also House Record quoted defendants' brief, page 133: "This section establishes the mechanism by which holding companies are brought under the jurisdiction of the Commission so that the provisions of the title may be effectively administered".

Act, and the specific provisions of the rigid control system are only appropriate to a company potentially in dissolution (defendants' brief, p. 103), but we nowhere contend that section 11 must, as a matter of law, be sustained to sustain the remaining control provisions if they are otherwise valid. That these provisions were in fact (however they may be regarded in law) primarily intended as auxiliary to the dissolution provisions is clear from the foregoing quotation. See also defendants' brief, Appendix A, pp. 127-138.

The quotations from the remarks of Senator Hastings (pp. 64-65) are from an opponent of the bill. They are not evidence in support of Congressional intent. *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488 (1931); *Wright* v. *Vinton Branch*, 300 U. S. 440 (1937); *Duplex Co.* v. *Deering*, 254 U. S. 443 (1921).

Independent Validity of Registration Provisions.

The independent validity of the registration provisions as a substantive regulatory measure (plaintiff's brief, pp. 69-82) is argued in a vacuum. It is said (pp. 70-73) that publicity is *per se* a valid means of regulation and was so admitted by the utility executives. This is not denied but is commented upon in defendants' brief (p. 65). Our argument throughout (pp. 61-63) is that the purpose and effect of the Act is control and not publicity without control.

Plaintiff's brief takes up each of the subdivisions of section 4(a) and purports to show that publicity with respect to the transactions prohibited therein to unregistered companies is a useful and valid regulation of those activities (pp. 74-82). The Government makes no attempt to

analyze the information called for by 5(b) in relation to the activities prohibited by 4(a); it simply asserts that "publicity" in general would serve a regulatory function. It is not the publicity of these transactions, but information as to the corporate structure upon which the controls of the subsequent sections of the Act are to be applied, that is the purpose of 5(b) (defendants' brief, pp. 61-64).

Comment may be made on the statements of the Government on pages 76, 79, 80 and 81 as to the function of publicity of the information of the registration statement in implementing state control of utility subsidiaries and in aiding Congress in future legislation (p. 74). We deny that the states are impotent to obtain this information (defendants' brief, p. 96, Appendix B, pp. 139-149, and note, p. 109, citing *Natural Gas Pipe Line Co.* v. *Slattery*), that to implement state regulatory agencies is any function of the federal government (*United States* v. *Constantine,* cited defendants' brief, p. 76), and that Congress has any power to vest a roving commission in an administrative agency to procure information as a basis for future legislation (*cf. Harriman* v. *Interstate Commerce Commission,* cited defendants' brief, p. 69).

Plaintiff discusses (pp. 91-145) serially the several prohibitions of section 4(a) and argues that the activities therein prohibited to unregistered companies are within the regulatory power of Congress and that for this reason the publicity or informatory requirements of 5(b) are valid and constitutional. The relevance of the information to the activities prohibited prior to registration is hardly discussed, much less shown. This argument is answered by defendants' brief (pp. 54-77), and we refer again to those pages.

Plaintiff (brief, pp. 145-157) purports to answer serially the points made by defendants against the regulatory function of section 5(b) in relationship to the activities of 4(a). The Court is supplied with the opposing arguments and each speaks for itself. Plaintiff's argument confuses the *powers* of Congress with its *intent*. We do not challenge the *power* of the federal government to regulate by any appropriate means within the limitations of the due process clause some of the activities specified in 4(a), nor do we argue that delay in the filing of the registration statement invalidates the exercise of such *power*. The argument is that the structure and content of 4(a) and 5 (including the time relationships as one element) shows that regulation by publicity was not the *intent* of Congress.

We do not understand the repeated description of section 22 as appearing on pages 149 and 150 (and earlier on page 8) by which a provision granting a discretionary right to make public registration statements and other documents if in the interest of the public, the investor or the consumer is tortured into a mandate to make them public. The section makes unlawful the disclosure of any such information which is not affirmatively made available to the public.

We again emphasize the distinction pointed out in our brief (pp. 61-62) between this Act and the Securities Act of 1933. Under this Act use of the channels of interstate commerce or the mails is conditioned upon required publicity (a prospectus must accompany or precede every delivery of a security through the mails or channels of interstate commerce—sec. 5) relevant to the particular use. Here, the use of these facilities is not conditioned on publicity, nor is the information relevant to or required in connection with any such use. It is, as we have shown, required to

implement the control of holding companies and their subsidiaries. As a practical matter, investors all over the United States cannot be benefitted by a voluminous statement filed with the Securities and Exchange Commission at Washington available to them only by going to Washington to inspect it or by purchasing copies at a folio rate.

On pages 152 and 156 the discretionary powers of the Commission with respect to the registration statement are sought to be limited by both the presumption of propriety of exercise, and the standards of the Act "the public interest or for the protection of investors or consumers." Since, however, as we point out in our brief (pp. 68-70), no information is required until the Commission exercises its discretion and determines what shall be furnished, and all information required by the Commission in its conception of the public interest or that of investors or consumers as to all companies in the system must be furnished, we are unable to see how the statute can be made effective at all without the Commission first exercising its unlimited discretion.

The subject matter of pages 158 to 181 of plaintiff's brief—the purported right of Congress to prevent the use of the mails or channels of interstate commerce in a manner deemed by it contrary to sound public policy—is totally irrelevant to the issues in this case, as shown in the brief itself. The argument is based on the prohibitions of section 4(a). The function of 4(a) is described on page 91, as follows: *"The registration provisions of the Act have no different effect than if they read: 'Any holding company which shall do any of the following acts in interstate commerce or by use of the mails [as enumerated in section*

*4(a)] * * * shall file a notification of registration and a registration statement * * *.'"*

In other words, the Government admits that the exclusion provisions are not regulatory prohibitions *but merely enumerate the holding companies required to register.* What relevance, then, has the power of Congress *to exclude certain articles from the channels of commerce or the mails* to the validity of sections 4(a) and 5(b)? In the cases sustaining statutes prohibiting the interstate transportation of stolen automobiles, diseased livestock, lottery tickets and the like, which are relied upon by the Government to support the validity of 4(a) and 5, the prohibition sustained was itself the regulation. Here, by the Government's own statement, the prohibition has no function other than as an enumeration of the holding companies which must register. This is but another way of expressing our contention that the function of 4(a) is not to exclude holding companies from the use of the instrumentalities of commerce or from the postal facilities, but is to compel holding companies to submit to regulation. The question of the *power to exclude* is completely immaterial.

The question is, we believe, sufficiently, though briefly, covered by our brief (pp. 72-77) and requires no further answer in detail. On page 162 of its brief, the Government states that defendants renew the suggestion that the power of preventing misuse of the channels of interstate commerce can be exercised only with reference to articles intrinsically harmful and then only by absolute prohibition and not by regulation (defendants' brief, p. 73). Reference to the page cited discloses no justification for the paraphrase.

The Cross-Bill.

The argument of the Government with respect to the cross-bill (pp. 204-255) has been anticipated in defendants' brief (pp. 112-125) and little further statement is necessary accurately to express the divergent views of the parties.

We point out only that, with respect to the question of threats, the quotation from the record is incomplete. True, it is stipulated, as stated by the Government, that there has been no threat against the defendants to institute civil or criminal proceedings for violations of the Act (brief, pp. 225-226, citing R. II, 271-275), but the stipulation gives reference to the published releases of the Attorney General, Postmaster General and Commission in which it is clearly indicated, as stated in our brief (p. 121), that it is intended to enforce the Act and that the purpose of this suit is to implement that enforcement.

Further, the stipulation recites (R. II, 274-275) that the Court may take judicial notice of rules, regulations and orders issued by the Commission, and that the stipulation shall not be construed as admitting or denying the duty or discretion of the Commission to enforce the Act by civil action, fines or penalties, subsequent to final decree by the court of last resort in this case ordering registration. Our brief calls attention to the daily activity of the Commission in administering the Act (p. 122).

The "Factual Summary".

Plaintiff has filed as Appendix "B" to its brief a so-called "Factual Summary" from which a few conclusions are translated to the main brief (e.g., pp. 12-14). This summary is entirely without relevance to the issues in this cause or the determination thereof in this Court.

No issue was raised by the pleadings, and no findings were made by or requested from the court below, on the propriety of the capitalization, the soundness of the securities, the reasonableness of the service charges, or the economic soundness of the holding company "systems" represented by the principal defendants here.

The pleadings, the stipulation and the findings are directed to the establishment of the facts which subject defendants to the Act, of its impact upon them, and of their present and threatened violations thereof. These material facts are admitted by defendants' pleadings, affirmatively alleged in their cross-bill, found by the court (no assignment of error being addressed to such findings) and assumed throughout defendants' brief here.

The factual brief is entirely superfluous to the issues here. It can have no possible purpose or function except to endeavor, by elliptical references, innuendo and misinterpretation, with which it is replete, to create an atmosphere of prejudice against the defendants.

Except in so far as it fully and accurately states the facts as stipulated, we challenge this brief in its entirety and shall assume that this Court will not accept statements of counsel which are not supported by the stipulation or the findings.

However, in view of the filing of this critical "factual summary" and in justice to our clients, we may be permitted the following comments upon matters which are quite irrelevant to a determination of this case.

Any fair valuation of the achievements of the defendants in the public service and in the development of the electric and gas industries, with due regard to their obligations to both security holders and the consumers served by

their subsidiary companies, must concede that, on balance, they have served and not betrayed the public interest and the interest of investors and consumers. This constructive achievement has been discussed in our brief (pp. 14-22).

While the Federal Trade Commission stated, as cited on page 26 of plaintiff's brief, "the Commission is of the opinion on the whole that the detriment of the public utility holding companies to the public has exceeded, thus far, their value to the public", this is a generalization and not a finding of fact, and, as a generalization, is not supported by the record in this case as to these companies, nor by the summary report of the Federal Trade Commission itself (Pt. 72-A) which clearly gives credit to the holding company for having developed, as these defendants have done, the electric public utility industry of the country, and supplied the two necessary elements for that development, viz., capital and management, which were locally unavailable except in large centers of population.

As illustrative of holding companies which, like those in the Bond and Share system, have assembled in a common financial group widely scattered properties serving smaller cities and towns, it may be remarked that any one of the four primary holding companies involved here has annual gross earnings far less than half those of the Consolidated Edison Company which serves New York City and surrounding territory, and within a comparable range to such companies as the Commonwealth Edison Company of Chicago, and Pacific Gas & Electric Company of San Francisco.[1]

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[1] The above generalization is based upon figures taken from Moody's Manual Public Utilities for 1937 (see pp. 68, 332, 1023, 1248, 1858, 1906, 1947).

Whether this volume of business and earning power necessary to create a financial background may be obtained in a widespread contiguous area, as in the case of American Gas and Electric Company, or requires the combination of properties in widely separated areas, as in the case of American Power & Light Company, is largely a matter of density of population and character of the areas served.

For example, Texas Power & Light Company, a subsidiary of the American company, serves 106,000 customers in 282 communities (R. III, 519, VII, 2112, 2134) in 63 counties having an area of over 55,000 square miles. This area is equal to that of the States of Massachusetts, Rhode Island, Connecticut, New Jersey, Delaware, Maryland, southeastern New York and eastern Pennsylvania, while the total number of customers served is only approximately equal to the customers in a single moderate sized city.

The generalization of the Trade Commission on the balance of evil and good is based upon its condemnation of manipulations of the management of holding companies in particular sections which resulted in financial collapse of particular companies with great and permanent loss to investors, upon its criticism of particular practices, largely in capitalization and accounting, which did not conform to its concepts, and upon specific transactions of particular companies which it regarded as unsound.

We have mentioned these facts upon page 23 of our brief, and admitting them to be true and that federal regulation may be appropriate to the correction of those abuses which affect interstate commerce, we stand on the statement there made that the record refutes any charge that the holding company *per se* is an agency which may be out-

lawed from the field of interstate commerce under rules of decisions applicable to inherently evil practices.

It may be remarked that the original bill for this Act concluded the section corresponding to the present section 1 with the statement that legislation was necessary "to control and eliminate the holding company as an artificial corporate device inherently injurious to investors, consumers, and the general public" and the purpose of the Act was declared to be "to provide at the end of five years for the abolition of the public-utility holding company", without exception or qualification.[1]

The Act, as passed, is cast in the subjunctive and states that when the enumerated abuses become widespread, a holding company "unless regulated, is injurious to investors, consumers and the general public", and it is proposed to "eliminate the evils" connected with holding companies and to provide for the elimination of holding companies "except as otherwise expressly provided".

The Hearings before the Congressional Committees must have at least convinced those Committees that the dogma of the original bill was unsupported.

Coming now to the "Factual Summary" filed here as Appendix "B" to plaintiff's brief, and without limiting the general challenge to its atmospheric color, and to details not specifically supported by the record, we observe briefly that three charges of substance are made against the defendant holding companies here.

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[1] See Hearings before Committee on Interstate Commerce, United States Senate, S. 1725, p. 10; see also Hearings before House Committee, Part I, p. 2. The text of the bill itself permitted a conditional survival to a strictly limited class of holding companies.

First, that they, particularly Bond and Share, have obtained control of vast properties with a comparatively small investment of their own funds.

Second, that they have stated their capital accounts at sums largely in excess of the costs of their properties; in other words, have "written-up" their capital accounts.

Third, that Bond and Share has made large profits from its supervisory services.

We shall comment briefly on these charges.

Investment of Bond and Share in Proportion to Total Investment.

Throughout the briefs in this Court, American Gas and Electric Company is included as a subsidiary of Electric Bond and Share Company and all the figures of investment, earnings, movements of electricity in interstate commerce, and the like, embrace American Gas and its subsidiaries as part of the Bond and Share system. Merely for the sake of preserving the record for the future, it may be said that it has been the position of both Bond and Share and American Gas, and remains their position, that except to the extent that the Act makes 10% voting stock ownership *prima facie* control so that Bond and Share, having approximately 17% of that voting stock, is *prima facie* a holding company of American Gas under the Act, it is not conceded (but the contrary assertion is made) that Bond and Share, in fact, controls American Gas, or that the American Gas properties are properly a part of the Bond and Share system. This position is protected in the findings of the trial court in this case (R. VIII, 2228).

It is asserted that the investment of Bond and Share in its principal subsidiaries is relatively insignificant, leading to the conclusion that "the pyramided Bond and Share empire was built up and maintained with other people's money, and that money was obtained by the marketing of securities through the mails and the channels of interstate commerce" (factual summary, pp. 49-50). In place of the $4,000,000 calculated on page 47, the stipulated record states that Bond and Share's investment in the securities of the domestic holding companies is in excess of $200,000,000 (R. II, 299). No other basis of comparison to total investment is available in the record.[1] It is gratuitously charged that the purchases of stock of subsidiary companies made subsequent to 1928 were "improvident" and that the funds invested were "frittered away in wanton speculation" (factual summary, 52-53). Thus, it appears that the Bond and Share management is to be

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[1] The table on page 46 of the factual summary calculates the total investment as of December 31, 1935 by including at stated or par values the stocks, funded debt and surplus of not only the four principal domestic holding companies, but also of American & Foreign Power Company Inc. There are no figures in the record indicating the comparable investment as of December 31, 1927. Bond and Share's investment of $4,000,000, shown on page 47, is computed as of December 31, 1927 and excludes entirely the investment of Bond and Share in bonds and other debt securities of holding companies or operating companies, and is calculated upon the basis of cash investment in stocks, whereas it is compared with ledger values of the securities shown in the table on page 46. By purely arbitrary assumption, it is said that the aggregate of the 1927 investment in controlled domestic utilities exceeded $1,000,000,000 and that this investment was controlled by $4,000,000. Why cash investment should be compared with ledger values irrespective of cash investment, or why investment in stocks only should be compared with investment in stocks and bonds, or why ledger values represented by surplus accounts should be included on one side of the calculation and not on the other, are explicable only as a deliberate effort to create prejudice.

condemned for pyramiding if it does not invest the larger portion of its funds in subsidiary securities and for wanton speculation if it makes such investment.

In the light of infallible hindsight, which has the benefit of appraising the effects of subsequent events which are matters of common knowledge and almost daily comment in the press, it may be contended that the investments *have become* unwise, but that they constituted wanton speculation when carried both through the boom of 1929 and the subsequent depression cannot fairly be charged. These stocks were acquired for investment because the management believed in them, not for speculation.

Apart from the above considerations, and assuming the measure of control said to be exercised by Bond and Share, the basic questions are the manner in which such control was obtained and in which it is exercised. It is not charged that it has been exercised to the detriment of the controlled companies, and the whole record is emphatic to the contrary.

With respect to the manner of the acquisition of control, the Stipulation expressly recites that when the holding companies were organized it was with the intention and understanding of the investors who went into them that those companies and their subsidiaries should be supervised by Bond and Share (R. II, 394). The investors who purchased the holding company securities, as such companies were organized, did so pursuant to prospectuses or financial plans under which they received notes, debentures, or preferred stocks, with common stocks, and, in some cases, option purchase warrants as part of units of securities purchased (Exs. 32, 36, 38; R. IV, 931, 954, 978). There is not a case in the so-called Bond and Share system where common

stock of holding or operating companies was originally sold to the public except as a part of and in connection with (as an inducement to purchase or a bonus, if you will) other securities. All subsequent issues of common stock were by way of stock dividends or stock split-ups or the exercise of rights or purchase warrants which followed the original issue ratably to all stockholders. Prospectuses or circulars offering other securities of any of these companies for sale recited that the issuing companies would be under the supervision of Bond and Share (R. II, 423). In other words, investors knew exactly what they were getting, got exactly what they contracted for, and knew they were going into enterprises which were to be under Bond and Share's supervision.

Incidentally, the interest of investors obviously comprehends Bond and Share's own 130,000 stockholders, the largest of whom owns only 1.5% of the company's stock (R. II, 301). There could not be any charge that the control of Bond and Share is concentrated in a few individuals or in any group or groups.

Counsel assert (factual summary, p. 44) that the real owners of the operating companies in the Bond and Share system are the senior security holders of such operating companies and that they have been deprived of any real representation in the management of such properties. More than two-thirds of the senior security holders to whom counsel refer are holders of mortgage bonds and are therefore creditors, *not owners*, of the operating companies. The theory that a lender of money under an unmatured mortgage on a farm (or on the property of a public utility company) either owns that farm or is entitled to participate in its management is, at least, novel. It is true that some

non-voting preferred stocks were issued by operating companies in the Bond and Share system, but more than two-thirds of the aggregate number of preferred shares issued by operating companies in the American Company, Electric Company and National Company groups, to which Bond and Share has rendered and Ebasco now renders general services, have full voting rights (Exhibits 17, 20, 25; R. IV, 770, 792, 827).

Write-Ups.

The use of the term "write-up" by the Federal Trade Commission is so varying in its connotations that it is difficult to generalize as to either justification or condemnation. About as good a definition as may be deduced from the various uses of this term in the Commission's calculations is that a write-up results from the inclusion in capital accounts of any item either at a value or on an accounting theory with which the examiner disagreed or which he considered questionable in the light of such information as was then available to him. The total figures given by the summary report, or any collection of write-up figures computed by the Trade Commission for a group of companies, represent merely the aggregation by a tabulator of what a number of different examiners considered to be improperly capitalized items and such totals often included substantial duplications. Not infrequently the figures reported were assumed or estimated by the examiners and derived without an examination of the books of the company against which the write-up was charged. There was no definition, either at the outset or the conclusion of the investigation, of a write-up. So far as the record discloses, no instructions were given to examiners; their judg-

ments and decisions were unguided and the results reported are consequently not comparable.

Write-ups, as thus variously defined, are included in the totals, whether made by holding company managements, or the managers or promoters of independent operating companies, or whether they occurred under holding company control or at the time of acquisition by the holding company, or before acquisition by the holding company, and regardless of the purpose for which they were made, whether they had any effect on securities held by the public, or whether they resulted from transactions between affiliated or non-affiliated interests, or by reason of an accounting entry or a failure to make an accounting entry and with little recognition of the extent to which alleged write-ups eliminate in consolidated balance sheets.

Counsel devote several pages (factual summary, pp. 10-13, 18-20, 26-28, 34, 39) to the so-called "write-ups" in the Bond and Share group, prefacing their discussion with a footnote (p. 11) which states that the Federal Trade Commission's figures may be "accepted for the purpose of this proceeding as an approximation." The record shows that, while the defendants admit that the ledger values on the books of certain companies referred to in the tables attached to Exhibit 31A (R. IV, 914) were substantially in excess of (1) ledger values on the books of predecessors, or (2) cost to the seller, they contend "that the determinations and conclusions made by the examiners of the Federal Trade Commission *are not accurate,* but that such examiners made one or more assumptions in arriving at such determinations and conclusions, which assumptions * * * *were erroneous*" (R. IV, 916-917). Defendants also contend and the plaintiff and cross-defendants do not deny

(even though they do not concede) that "when the capital accounts of the holding and operating companies in a single holding company system are consolidated in accordance with accepted accounting practice, the greater portion of the appreciation in ledger values found by the examiners of the Federal Trade Commission is eliminated, and that of the portion not so eliminated, a substantial part represents the amount by which actual cost of properties and securities acquired in arm's-length transactions exceeded the ledger values of such properties and securities on the books of predecessor owners" (R. IV, 917).

In his testimony before the House Committee on Interstate and Foreign Commerce, Mr. Inch, President of Bond and Share, in the course of a discussion of the "write-up" problem (House Hearings, p. 1133) said, among other things, "Total securities [in the Bond and Share group] outstanding with the public are less than total book assets after deducting all so called 'write-ups' ".

The parties agreed that *"it is unnecessary to an adjudication of the issues in this proceeding that this court make any determination or findings"* as to *"(1) whether the results obtained by the examiners of the Federal Trade Commission * * * are or are not accurate, and (2) whether the ledger values * * * upon the books of the acquiring companies did or did not represent fair and reasonable values"* (R. IV, 920-21). In the face of this record, how can counsel contend that the Federal Trade Commission's figures may "be accepted for the purpose of this proceeding as an approximation" or at all?

It may be conceded that the original statements of capital represented by assets and liabilities on the opening balance sheet of operating companies, on their being set

up by their respective holding companies, represented the judgment of the persons responsible therefor as to capital *values,* as distinguished from *costs.* In so valuing and capitalizing their assets, however, these companies were acting in accordance with the laws of the states in which they were organized, which authorize the statement of the value of assets and the issue of securities against such value.[1] Statements of value in the early days undoubtedly were influenced by the necessity for the issuance of so-called bonus stock having a par value, with other classes of securities, as inducements to investment. But it would be hypocritical not to admit the practical necessity of this method of finance in a new industry in this country.

It is conceded by plaintiff and cross-defendants in their factual summary that investment bankers had little interest in the utility industry until the 1920's, and that "investment bankers have seldom played an important part in the early development of many of our great industries" (p. 5). Whatever may be said today as to the wisdom of permitting unrestricted discretion to directors in stating values, no one can deny that in the competitive market for capital for the development of a new industry, inducements in the nature of so-called bonuses had to be extended to investors.

Typical of the wholly unjustified charges (factual summary, pp. 13, 19, 28, 34, 39) that securities were issued to the public on the basis of inflated values is the statement (pp. 12-13): "In 1933, the ledger value of Appalachian Elec-

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[1] See, for example: Pennsylvania Business Corporation Law, Sec. 2852-603; Ohio General Corporation Act, Secs. 8623-25; Virginia General Corporation Law, Sec. 3788; California General Corporation Law, Sec. 300(a), as amended by Ch. 533, Laws of 1933; Idaho Code, 1932, Sec. 29-122; Delaware General Corporation Law, Sec. 14; Washington, Rem. Rev. Stat., Sec. 3803-17, 18.

tric Power Company plant and investment was written down $42,590,485.29 (R. 930), *but only after millions of dollars of securities had been issued* (R. 1869, 1894)." This reference lists the Appalachian Company securities sold to the public as aggregating $49,601,300 par value of securities. These securities were issued against property in which American Gas had invested $62,690,900 (F. T. C. Reports, Part 22, p. 943). The remainder of the securities issued consisted substantially of stock without par value held by American Gas *at cost*. The consistent record of American Gas and all of its subsidiaries in meeting all service charges on all debt and preferred stock issues has been commented on in defendants' brief (pp. 19-20).

The statement (factual summary, p. 8; see also pp. 25, 33, 36, 49) that Bond and Share did not to any appreciable extent or for any extended period tie up its own funds in financing the development of local operating companies is erroneous. Securities of various operating companies subsequently transferred to holding companies were carried (and their financing was done) by Bond and Share itself for varying and often protracted periods. For example, the securities of the predecessor in interest of Nebraska Power Company were carried by Bond and Share from 1905 to 1917 (R. IV, 940-1); those of Dallas Power & Light Company from 1919 to 1925 (R. IV, 959); those of New Orleans Public Service Inc. from 1922 to 1925 (R. IV, 958) and those of Carolina Power & Light Company from 1908 to 1925 (R. IV, 983-4), not to mention the financing of United Company and its subsidiary, United Gas Public Service Company (involving the investment by Bond and Share of an additional $25,000,000 in the debentures of United Gas Public Service Company) which counsel dis-

cuss at some length (factual summary, pp. 36-40), loans to domestic holding companies (aggregating more than $250,000,000 in the period from 1926 to 1935) which in turn were made the basis of advances to operating companies (R. VI, 1831ff.) and Bond and Share's present investment of more than $200,000,000 in securities the proceeds of which were directly or indirectly employed in developing operating companies (R. IV, 847-849).

The statement is made (factual summary, p. 104), that, when the operating companies required funds, "instead of going directly to the public, they passed their securities up through the holding companies to Bond and Share at the top of the pyramid to arrange their sale through bankers to the public." *Per contra,* sales of securities were made by both operating and holding companies directly to purchasing groups in New York City. It is true that the negotiations leading to securities sales normally were carried on by officers of Bond and Share in behalf of operating companies, but the purchasing groups made contacts directly or through Bond and Share with the company actually issuing the securities purchased (R. II, 417-424). The statement (factual summary, p. 105) that "what was left", after the deduction of banking and holding company commissions from the purchase price, flowed back to the operating properties gives a wholly erroneous impression. Exhibit 96 (R. VI, 1854-1894) shows that, particularly within the last ten years, the "spread" or commission allowed bankers was so small as to challenge comparison with the financing done by other groups within or without the public utility industry and we submit that the fees charged by Bond and Share for its services in connection with the sale of securities (R. V, 1173-1176) were similarly reasonable.

To talk of 95% or more as being "what was left" after the deduction of all costs and commissions is obviously unfair innuendo.

Services and Service Fees.

It is charged that "Bond and Share for years past has made and Ebasco now makes, despite successive reductions in fees grudgingly and belatedly made as a concession to public opinion, enormous profits from service contracts" (factual summary, pp. 98-101).

As stated in our main brief (pp. 108-109), there is no contention that, in the case of companies related as these are, service fees and their relationship to cost as well as to the value of the services rendered are not proper subjects of regulation by appropriate authorities, but this record affords no justification for the condemnation of admittedly beneficial contractual arrangements solely because the business has been profitable.

The discussion of the bases upon which service fees are charged is another distortion of the record (factual summary, pp. 82-84). No reference is made to reductions of the basic fees (R. II, 390), to the negligible incidence of charges for special services since 1933 (R. VI, 1815), to the fact that no such charges have been made since the formation of Ebasco (R. V, 1086), or to the negligible amount of construction work done by the construction company since 1933 (R. VI, 1820ff.), and the statement that changes in fees involved "increased charges for unchanged services and decreased services for unchanged fees" is wholly unjustified (R. II, 390-391).

And, of course, no attempt has been made to show that rates charged by operating companies in the Bond and Share group have not compared favorably with those charged in thickly settled and highly industrialized areas, nor could any such attempt succeed (see defendants' brief, p. 18).

The record is completely lacking in justification for the statement that fees formerly charged by Bond and Share (and now charged by Ebasco) for services are in any sense "exorbitant." The extent and character of the services rendered are set forth at length in the stipulation (R. II, 352-392; Ex. 91, R. V, 1648-1767) and counsel have not attempted to assert that the value of such services to the operating companies served may not greatly exceed the fees which they pay (see for example Ex. 91; R .V, 1648-1767).

The major objective of section 13 of the Act (not to mention the emphasis of counsel's brief) is the elimination of all profits from service arrangements, however meritorious such arrangements may be in other respects. The fact that services often have a value to operating companies greatly in excess of the fees charged and that, under the guidance of a particular service organization, companies operating in sparsely settled, non-industrialized areas (e.g., Texas, Utah, Idaho, Montana, Washington, Oregon) have been able to render metropolitan service at rates below the national average apparently lacks all significance so far as 13 is concerned.

The present fees, on the basis charged for the last two years, average approximately 0.9% of the operating revenues of the serviced companies (for schedule, see R. II, 390).

This rate compares with similar percentages of gross revenues, ranging from 0.9% to 2%,[1] approved by the Commission as initial charges proposed to be made by service companies which have qualified under section 13.

Interstate Commerce.

While the disagreement is of no importance, we do not accept the statement on page 12 of plaintiff's brief which, in turn, is derived in part from the factual summary, that more than 31% of total electric energy generated by Bond and Share subsidiaries is transmitted across state lines and more than 25% of all electric energy so transmitted in the United States is handled by Bond and Share subsidiaries (citing R. VIII, 2231-2232). The findings referred to in these citations are that subsidiary companies own approximately 30% of total mileage of transmission lines within the United States; that not less than 25% of the electric energy handled by subsidiaries of Bond and Share is sold, purchased or transmitted across one or more state lines; that wholesale sales of energy at or across state

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[1] Securities and Exchange Commission Releases Nos. 289, 351, 566 and 805. This is not an exhaustive comparison; there are varying bases of charges, and some may be outside of this range on either the up or down side.

lines by these subsidiaries amounted in 1934 to $5,417,691 out of total electric revenues of $232,865,299.

Respectfully submitted,

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